

In the Matter of the Appeal of)
ARCHIE L. MAYO)

For Appellant: B. L. Aldrich and L. W. Butterfield,
Certified Public Accountants

For Respondent: W. M. Walsh; Assistant Franchise Tax
'Commissioner; Hebard P. Smith,
Associate Tax Counsel

This appeal is made pursuant to Section 19059 of the Revenue and Taxation Code (formerly Section 20 of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner in denying the claims of Archie L. Mayo for refunds of personal income tax in the amounts of \$76.87, \$53.31, \$46.70 and \$44.71 for the taxable years 1939, 1940, 1941 and 1942, respectively.

Prior to the years specified, Mr. Mayo entered into substantially similar contracts with various insurance companies, each contract providing for the payment of a life annuity to Mr. Mayo plus a principal sum payable either upon his death to a named beneficiary or to him personally during his lifetime on demand and surrender of the contract, the annuity in each instance being equal to about 3 or 3½ percent of the principal sum. As consideration, Mr. Mayo, with one exception, made a payment under each contract in advance in the form of a single premium, the payment exceeding the principal sum payable by the insurance company in an amount equivalent to a "loading charge" to compensate the company for handling the contract. In the case of the exception, the premium was payable in installments to be completed within the first five months of the period of the contract. Each contract indicated that a portion of the premium was allocated to a "life annuity" and a portion to "life insurance". No medical examination was required, however, as a condition to the issuance of any contract, and the insurer assumed no risk other than to make the payments mentioned. In addition to the right of surrender, Mr. Mayo could assign a contract, change the beneficiary and borrow up to the amount of the principal sum.

Annuity payments made under the contracts to Mr. Mayo in 1939, 1940, 1941 and 1942 were reported by him and his wife in equal shares as gross income in their returns for those years. Subsequently, however, on behalf of himself and his then deceased wife, he filed claims for refunds of the taxes paid by reason of

Appeal of Archie L. Mayo

the inclusion of the annuity income on the ground that the portion of such income which exceeded 3% of the amount allocated by the insurers to "life annuity" was excludible under the following language of Section 7(b) of the Personal Income Tax Act of 1935 (now in Section 17124 of the Revenue and Taxation Code);;

"2....Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this act in respect of such annuity increased by the amount which would have been excluded from gross income in respect of such annuity had this act been in effect continuously from and after the date at which payments under such annuity were first received equals the aggregate premiums or consideration paid for such annuity...."

The Commissioner denied the claims on the basis that the policies are in the nature of loans to the insurance companies and the payments received by Appellant are income from those loans.

In a closely parallel case, the United States Circuit Court of Appeals recently held in Iglehart v. Commissioner of Internal Revenue, 174 Fed. 2d 605, that the annuity payments there involved were taxable in their entirety to the recipient, notwithstanding Section 22(b)(2) of the Internal Revenue Code, which is similar to former Section 7(b) of the Personal Income Tax Act. The Court took the position that Section 22(b)(2) could be construed as referring "only to periodic payments which represent a combined return of capital and interest," and that it was never intended thereby to exempt payments which in their entirety represent interest and do not deplete the principal sum invested." 174 Fed. 2d at 607. The action of the Franchise Tax Commissioner should, accordingly, be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 19060 of the Revenue and Taxation Code, that the action of Chas. J. McColgan, Franchise Tax Commissioner, in denying the claims of Archie L. Mayo for refunds of personal income tax in

Appeal of Archie L. Mayo

the amounts of \$76.87, \$53.31, \$46.70 and \$44.71 for the taxable years 1939, 1940, 1941 and 1942, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day Of.
September, 1949, by the State Board of Xqualization.

Geo..R. Reilly, Chairman
J. H. Quinn, Member
J. L. Seawell, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary